August 08, 2019

Federal Trade Commission
600 Pennsylvania Ave NW
Washington, D.C. 20580
Attn: Docket USTR-2019-0009

Re: Americans for Tax Reform comments on the initiation of a Section 301 investigation of France's Digital Services Tax

Americans for Tax Reform (ATR) is an advocacy organization dedicated to the protection of American taxpayers in the United States and around the world.

ATR submits the below comments on the initiation of a Section 301 investigation of France's digital services tax (DST). The intention of the French DST is to tax the revenues of major technology companies in order to recoup their purported "fair share" of tax revenue that is not paid by companies due to their not having a physical presence in France.

We argue, however, that the French DST is the wrong direction for global tax policy. It is a unilateral move that is highly discriminatory to American companies, and its effects will be felt by consumers as well as through decreased global innovation and trade.

Instead of enacting a DST unilaterally, the French government should wait for a global consensus on the taxation of the digital economy to be reached by the Organisation for Economic Co-operation and Development (OECD). This consensus will be reached with the input from all affected parties and reflect the interests of taxpayers and tax collectors alike. ***For these reasons, ATR fully supports a Section 301 investigation of France's DST and a finding that the DST warrants a Section 301 action.***

To fully illustrate why we believe this is the case, we have organized this paper to cover six main points:

1. The French DST violates long-held principles of international tax policy.
2. The French DST targets American companies and violates EU law.
3. The European Union could not reach agreement on a DST and is waiting for the OECD to act.
4. A DST will harm the innovation ecosystem.
5. The French DST will compromise the U.S. tax base and lead to further base erosion.
6. The effects of the DST will be mostly borne by consumers and small businesses, not the big technology companies it wishes to affect.

<u>The French DST violates long-held principles of international tax policy</u>

The very premises on which the French DST is founded are flawed. Under current international tax rules and treaties, a company is only subject to corporate tax on its profits in countries where it has a

physical presence.[1] This nexus requirement precludes issues that can arise from countries having unlimited taxing rights to companies that may operate within their borders but have no presence there. France is an Inclusive Framework on BEPS member, of which these rules are a part. These rules were seemingly adopted to avoid the very issue brought by the French DST – a country who seeks to tax a company that has no physical presence within its borders.

While being in direct conflict with the current rules on profit allocation and nexus requirements, the French DST also abandons the long-held standard of taxing profits by taxing revenues of the targeted technology companies. This violates the principle that companies should only be taxed on their actual gains from doing business, and leaves open the possibility to being taxed on a loss.

A quick example illustrates this problem. A company that spends $100 and earns $90 is operating at a loss. At a 10% tax on its profits, the normal target of corporate taxation, the company would not be subject to tax. However, if the 10% tax is on the revenues, the $90 in earnings, the tax would be $9 on a company that is already losing money. This is a clear disincentive to new businesses that want to enter the marketplace but may require a few years to earn a profit.

The French DST targets American companies and violates EU law

The French DST does not explicitly target American companies by name or nationality, but it accomplishes this goal through its revenue thresholds. By only taxing the revenues of companies that earn more than 750 million Euros annually, the law exempts domestic companies and effectively targets large American technology companies. Through its effects, the revenue thresholds serve as a proxy for nationality – rendering the DST definitively targeted toward, and thus discriminating against, American companies.

The discriminatory aspects of the DST also put it in conflict with European Union law. Under Article 107 of the Treaty on the Functioning of the European Union, a member state may not grant state aid or use state resources to distort competition in the EU marketplace.[2] The revenue thresholds in the DST do not subject French companies to the DST, while raising the tax burden of their competitors. This meets the definition of state aid, and French technology associations have begun proceedings to appeal the law to the European Commission.[3] Not only is the French DST discriminatory toward American companies in the respect that it only targets them with this tax, it also handicaps them versus their competitors in the European Union. It is discriminatory on two fronts.

Even if one were to assume that France's reasoning for a digital tax was valid, that technology companies are not paying their "fair share" of tax, the evidence points to the contrary. A report published in February by the European Centre for International Political Economy found that the

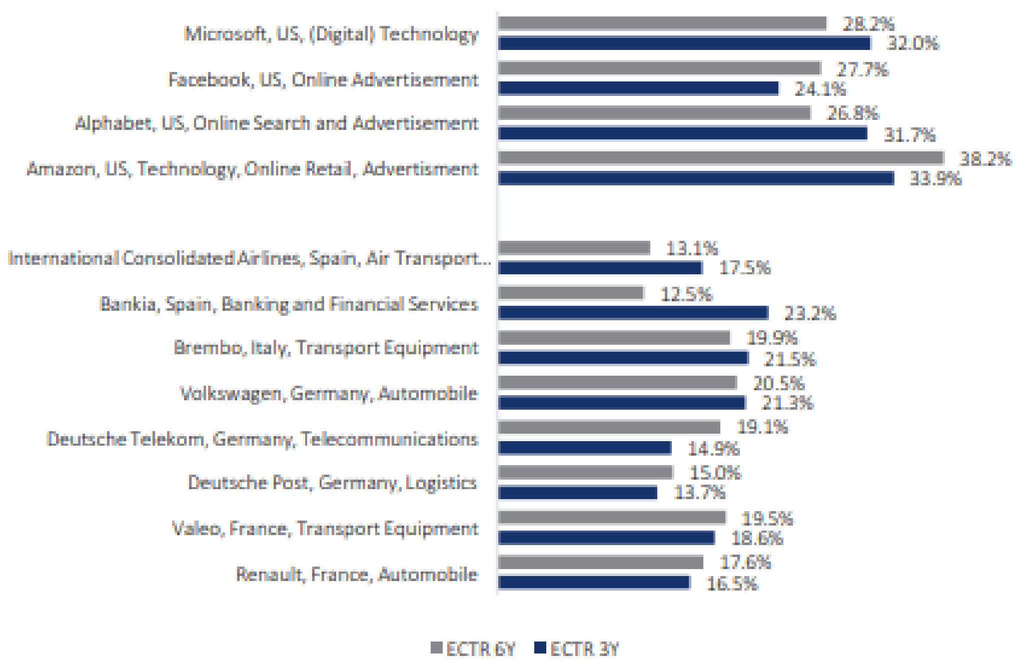
[1] Article 7 – Permanent Establishment Status, Organisation for Economic Co-operation and Development, https://www.oecd.org/tax/beps/beps-actions/action7/

[2] Consolidated version of the Treaty on the Functioning of the European Union - PART THREE: UNION POLICIES AND INTERNAL ACTIONS - TITLE VII: COMMON RULES ON COMPETITION, TAXATION AND APPROXIMATION OF LAWS - Chapter 1: Rules on competition - Section 2: Aids granted by States - Article 107 https://eur-lex.europa.eu/legal-content/EN/ALL/?uri=CELEX:12008E107

[3] Gottlieb, I. (2019, July 25). Big Tech Takes Fight Over Digital Tax to EU. *Bloomberg Tax*, https://news.bloombergtax.com/daily-tax-report-international/big-tech-takes-fight-over-french-digital-tax-to-eu

effective corporate tax rate for US-based digital companies was significantly higher than non-technology companies based in the European Union, including France.[4]

Figure 9: Average ECTRs of selected companies headquartered in Western EU Member States vs. large US-based "digital companies"



<u>The data, as seen in the figure above from the report[5], does not support the French claim that major technology companies are not paying their "fair share" of tax. In fact, they are paying higher rates than their European counterparts. The French DST proposal seemingly is more about targeting American companies than it is receiving their "fair share" of tax revenue.</u>

<u>The European Union could not reach agreement on a DST and is waiting for the OECD to act</u>

The French DST is similar to the proposal by the European Union (EU) to establish a DST across each of its member states.[6] The EU proposal called for a 3% tax on the revenues of technology companies that generated more than 750 million Euros in global revenue.

However, the EU abandoned its proposal after the Nordic countries and Ireland refused to back any version of a DST, even a watered-down proposal that only sought to target advertising revenues. Romania's Eugen Teodorovici, then President of the European Council, said that "ministers would

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[4] Bauer, M. (2019, February). *Corporate Tax Out of Control.* European Centre for International Political Economy. https://ecipe.org/wp-content/uploads/2019/02/Corporate-Tax-Out-of-Control.pdf

[5] *Id*

[6] Digital Taxation, Council of the European Union, https://www.consilium.europa.eu/en/policies/digital-taxation/

now focus on trying to reach a common position for an overhaul of digital taxation at a global level."[7]

This move by the EU to work toward a global consensus on the issue of taxation of the digital economy highlights the unreasonableness of the French DST. France is a member of the EU, and its Finance Minister Bruno Le Maire was seen as the lead proponent of the EU's DST proposal. The failure of the EU to adopt a DST has led to a unilateral move from France, as opposed to following the EU's example and waiting for a global consensus.

A DST will harm the innovation ecosystem

The profitability and success of technology companies is due in large part to their ability to innovate – to produce products and platforms that are in great demand by citizens around the world. The French DST would inhibit the innovative environment that has allowed this process to take place.

In a report on the proposed EU DST, economist Matthias Bauer called into question the effects of the DST on investment in the EU.[8] These effects would likely be the same for a French DST.

According to the report, the DST would be a pass-on tax whose effects will be much greater than the static effects due to higher prices to consumers. For companies that are dependent on external funding for its operating budget, a revenue tax would require much more capital in order to conduct business. A DST would likely reduce investment in these companies relative to companies not subject to the DST. This decrease in the relative attractiveness of an investment into the companies affected by the DST would result in a lower capacity for innovation in the digital sector, negatively impacting both down-stream businesses and consumers.

The French DST will compromise the U.S. tax base and lead to further base erosion

A key part of the Tax Cuts and Jobs Act (TCJA) passed in 2017 was to clearly define the United States' tax base and enact two new provisions, the "global intangible low-taxed income," (GILTI), and "foreign-derived intangible income," (FDII) to protect the tax base and encourage businesses to locate capital and profits in the U.S. The French DST goes directly against that and is a direct attack on the U.S. tax base as it will limit tax revenue for the Department of the Treasury.

Under the current international tax framework, companies are taxed on their profits in the country in which they are headquartered. This encourages tax competition that allows countries to compete for investment. In this respect, TCJA was a win for the American economy – making the United States a more attractive place to invest and grow a business. This is a win for producers and consumers facilitated by lower tax rates.

If the French DST becomes law without repercussion, companies will once again be incentivized to leave the United States and relocate abroad. The DST will tax these companies no matter where they

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[7] Guarascio, F. (2019, March 6). EU ditches digital tax plan, to work for global reform. *Reuters*, https://www.reuters.com/article/us-eu-tax-digital/eu-ditches-digital-tax-plan-to-work-for-global-reform-idUSKBN1QT1HC

[8] Bauer, M. (2018, June). *Five Questions about the Digital Services Tax to Pierre Moscovici*. European Centre for International Political Economy. https://ecipe.org/publications/five-questions-about-the-digital-services-tax/

are located, virtually eliminating the incentive granted to them by TCJA to stay in the United States. With higher tax burden regardless of where they are headquartered, companies will seek to trim their costs, whether regulatory or labor, where they can. This will likely result in an exodus from the United States to jurisdictions with a lower cost of doing business. Corporate inversions were seen to be a thing of the past after TCJA was passed, but the French DST and DSTs around the world will contribute to their revival.

The effects of the DST will be mostly borne by consumers and small businesses, not the big technology companies it wishes to affect

The French DST will not be mostly borne by large technology companies as the French government intends. According to a report from Deloitte, the increased tax burden will be borne by consumers and the small businesses that utilize the digital marketplace to conduct their operations.[9]

The increased tax burden is comprised of an upstream pass-on and a downstream pass-on. When the DST is applied to the revenue of the marketplace, the marketplace will increase the commission it charges merchants in order to compensate for the tax. Some merchants may leave the marketplace altogether due to the higher tax burden they will face.

For those that do not leave, they will pass on this tax burden downstream to consumers through higher prices to compensate for the higher commission rates.

The Deloitte report finds that 57% of the increased tax burden will be borne by consumers, 39% by merchants and advertisers that use the marketplace, and only 4% of the increased burden will be borne by the large technology companies. The facts are clear: American consumers and American small businesses that rely on the large technology companies will bear the burden of the French DST.

For these reasons ATR fully supports a Section 301 investigation into the French DST and a finding that it is unreasonable tax policy, discriminatory toward American technology companies, and will harm both American consumers and small businesses. ATR urges a strong response from the U.S. Trade Representative that deters other countries from implementing such a policy, and instead refocuses the world's efforts toward a global consensus that seeks input from all affected parties.

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